

CENTRAL VERMONT PUBLIC SERVICE CORPORATION

Q: Please state your name and business address.

A: My name is Ron Behrns. My business address is 112 State Street, Montpelier, VT 05620. I am currently employed as Utility Finance and Economics Director for the Vermont Department of Public Service ("DPS" or "the Department").

Q: Please describe your education and work experience

A: I hold a B.S. degree in Accounting and Management Science from Eastern Illinois University and an M.B.A. degree from Illinois State University. At Illinois State University, my studies were concentrated in Finance and Economics. Additionally, I hold CMA certification, have completed numerous postgraduate courses and am a member of the Institute of Management Accountants and the Society of Utility and Regulatory Financial Analysts. During the past twelve years I have been involved in private entrepreneurial business ventures and have been employed as a Senior Financial Analyst where I have provided consulting services that were specialized in policy formulation, strategic planning, financing and capital formation, regulation, financial analysis, accounting and marketing.

Q: Have you previously testified before the Vermont Public Service Board ("PSB")?

A: Yes. I have previously testified in several Dockets before the PSB.

Q: What is the purpose of your testimony?

A: The purpose of my testimony is to (a) summarize the findings and

recommendations in this case; (b) discuss Central Vermont Public Service's ("CVPS" or "the Company") proposed policy change to exclude VELCO, Vermont Yankee, Connecticut Yankee, Maine Yankee and Yankee Rowe from its Cost of Service filing - the effect of which is to reduce equity in earnings and rate base and to increase utility rates for CVPS ratepayers; (c) discuss rate making policy related to (i) the amortization of regulatory assets and regulatory liabilities and (ii) the interim measurement and calculation of rates of return when earnings caps are in place; and, (d) propose increased scrutiny of depreciation rates, net salvage amounts, accumulated depreciation and the related accounting for these items.

A. Summarize the findings and recommendations in this case

Q. Did CVPS file a Revenue Requirement or Cost of Service in this Docket?

A. Yes, CVPS filed a Revenue Requirement/Cost of Service on July 15, 2004 for the Rate Year beginning April 1, 2004 through March 31, 2005 under Docket No. 6946 that authorizes an investigation into CVPS's existing rates.

Q. Did CVPS file another Revenue Requirement or Cost of Service for the Rate Year immediately proceeding the Rate Year in Docket No. 6946?

A. Yes, on July 15, 2004, CVPS also filed a Request to Increase Rates along with a Revenue Requirement/Cost of Service for the Rate Year April 1, 2005 through March 31, 2006. In this filing CVPS requested that the two cases be consolidated.

Q. Did the Board open a new Docket for CVPS's Rate Increase Request?

A. Yes, the Board opened Docket No. 6988 and after indicating, that each Docket would be treated separately, they ordered the consolidation of the two dockets for scheduling and hearing purposes. These two cases are now commonly referred at Rate Year 1 and Rate Year 2.

Q. What was the scope of the Department's Rate Year 1 rate investigation?

A. The Department examined the normal items associated with a rate case that included:

- (a) known and measurable changes occurring within the Cost of Service test year of 2003, and through the rate year of 2004. The Board's Order opening this investigation was dated April 7, 2004, which, in effect, establishes a 2004 rate year for the period April 1, 2004 through March 31, 2005;
- (b) CVPS's capital structure;
- (c) cost of capital;
- (d) rate base including Working Capital;
- (e) Deferred debits and credits including Regulatory Liabilities and Regulatory Assets;
- (f) depreciation and related depreciation reserve;
- (g) management structure and organization including wage and salary ranges in light of the changes in scope, depth and breath of corporations operations and individual responsibilities;

- (h) customer service; and,
- (i) the sale of Connecticut Valley including the stranded cost implications.

The Department considered three other additional items:

- (1) CVPS's proposed change in rate making practices related to their affiliated regulated subsidiaries;
- (2) Clarification of Board policy related to the accounting for residual revenues associated with the completion of amortization of Regulatory Assets and or Regulatory Liabilities; and,
- (3) CVPS's request for an Accounting Order to defer certain costs associated with the unscheduled outage of Vermont Yankee.

Q. How was the Department's examination organized and carried out?

A. The Department retained the professional services of Larkin Associates, PLLC to conduct the detailed examination of CVPS's Cost of Service; Dr. Randall Woolridge was retained to conduct the cost of capital analysis; Snavelly King Majoros O'Connor & Lee, Inc. ("Snavelly King") was retained to conduct an examination of CVPS's depreciation rates and associated depreciation reserves; Ms. Carole Welch from the Department examined DSM, ACE and energy efficiency related issues; Mr. David Lamont from the Department examined purchased power and power production expenses along with decommissioning charges; Ms. Deena Frankel from the Department examined customer service related issues and I have coordinated finance, accounting and economic related

issues among the team. The external consultants were recruited and retained using the State of Vermont competitive bidding process. The Team assembled for this consolidated case has worked under the supervision and direction of the Public Advocacy Division. The findings and recommendations of the Team are covered in detail in the prefiled testimony. The Department intends to introduce the following witnesses to present their findings and recommendations in this case:

Helmuth W Schultz, III and Donna Deronne

Carole E. Welch

David F. Lamont

Deena Frankel

Dr. J. Randall Woolridge

Michael J. Majoros, Jr.

Ron Behrns

Q. How would you summarize the major findings and recommendations from the Department's examination?

A. One of the most significant findings in Rate Year 1 is that CVPS's existing rates produce a revenue stream that is over \$12 million, or about 5%, too high. The exact numbers are to be precise, CVPS is earning excess revenues in the amount of \$12,247,000. Expressed as a percentage, CVPS is over earning by 4.65%. This is in marked contrast to the Revenue Deficiency of \$6.336 million

CVPS has claimed in its Rate Year 1 filing, where the Company represented that its rates are too low and need to be increased by 2.4%.

In summary, the Department's investigation into the rates of CVPS has identified overstatements of expenses, understatements of revenue, overstatements of rate base and earnings adjustments totaling over \$18 million that need to be adjusted in their Cost of Service filing. After making these adjustments CVPS rate payers will enjoy a **rate refund** retroactive to April 1, 2004, as well as a **rate reduction** of almost 5% going forward through March 31, 2005.

- Q. What were your findings in Rate Year 2? Is the 5% rate refund in Rate Year 1 off-set in Rate Year 2 with a corresponding rate increase?
- A. CVPS has requested approval to implement a rate increase in Rate Year 2 of 5% or well over \$13 million. Upon investigation, the rate increase proposed by CVPS can not be justified. In fact, based upon adjustments proposed by the Department related to CVPS' overstatement of expenses, understatement of revenues, overstatement of rate base and adjustments for changes in the cost of capital, Vermont rate payers should receive a decrease in rates beginning on April 1, 2005 and continuing, at least through March 31, 2006. CVPS's excess revenues should be reduced to a just and reasonable level with a **rate**

reduction. Thus, at a minimum, CVPS's rates should be reduced by about 6% or all most \$16 million for Rate Year 2. The exact numbers are a \$15,626,000 or a 5.93% rate reduction effective with service rendered on April 1, 2005.

In summary, for Rate Year 1 CVPS customers should receive a **CASH REFUND** of about 5% or almost \$12 million. In Rate Year 2, there should be an actual **rate reduction** of about 6% or almost \$16 million. For the two rate years combined, Vermont rate payers will have received refunds and rate reductions totaling about \$28 million.

Q. How much of the rate refunds and rate reduction are due to normal adjustments in known and measurable changes versus changes in revenue requirement arising from changes in policy?

A. The recommended change in revenue requirement is broadly based and includes significant reductions attributable to all elements examined in this case:

- (1) changes in cost of service due to disallowance in known and measurable changes
- (2) changes in rate base
- (3) the Department has proposed no changes in CVPS's capital structure- even though it appears to be equity rich when compared with similarly situated entities
- (4) changes in cost of capital

(5) application of changes in policy related to:

- a. The exclusion of regulated affiliate subsidiaries (the Department is opposed to this change in policy) in developing the rate base and cost of service

In order of magnitude, the CVPS proposed policy change was not quantified by CVPS and the full impact of their proposal has not been determined; however, with the other adjustments proposed by the Department, a rate reduction even without changes in regulatory rate making policy is warranted.

Q. Beyond the recommended adjustments and policy choices that have been or will be testified to in this case, do you have any other suggestions for how the Board should respond to the recommended \$28 million reduction in CVPS's revenue requirement?

A. Yes. The Department recommends that:

(1) CVPS make a cash refund to customers estimated to total about \$12 million for service rendered from April 1, 2004 through March 31, 2005 on or before April 15, 2005;

(2) CVPS reduce rates 5.93% beginning with service rendered on April 1, 2005. This rate reduction will result in an estimated revenue reduction of \$15,626,000. In conjunction with this rate reduction, the Department recommends that CVPS implement the rate reduction coincident with the preparation of a Rate Class Cost of Service Filing to be submitted to the Board on or before January 15,

2005.

(3) The Department further recommends the Board deny the proposed change in rate making policy as proposed by CVPS

(4) The Department recommends that the Board make certain rulings regarding:

A. Amortization of Regulatory Assets and Liabilities-that upon completion of the amortization of regulatory assets and or regulatory liabilities, subsequent amounts remaining in rates will be specifically accounted and not immediately flowed through to the bottom line but rather recorded and charged as a Regulatory Asset or Liability.

B. The method for calculating interim rates of return when assessing conformance with earnings maximums and caps as prescribed herein. In its cost of service filing, CVPS calculated its over earnings for 2003 to be \$2,539,000. However, Department witness Schultz has determined that when using the correct methodology for this calculation, the actual over earnings for 2003 were \$6,845,000. Because of the materiality of this discrepancy and the attendant need for adjustment that it reflects, the Department recommends that CVPS be ordered to (1) recalculate its over earnings for the calendar years 2001 and 2002 using the correct methodology and adjusting the Regulatory Liabilities-Earnings Cap account as established in Docket 6460; and (2) restate its earnings as necessary.

(5) The Department recommends that CVPS's request for an Accounting Order to defer certain costs associated with the outage at Vermont

Yankee be denied.

(6) The Department recommends that the Board adopt a policy of more closely scrutinizing depreciation rates, depreciation reserve, depreciation studies, and accumulated reserve amounts transferred to Regulatory Liabilities.

(7) In the area of customer service, the Department recommends that the Board direct CVPS to remedy certain pervasive problems that exist throughout the Company that seriously detract from the quality of customer service consumers receive from the Company.

B. Discuss CVPS's Proposed Change in Rate Making Policy

Q: What specifically is CVPS proposing to change?

A: CVPS has proposed the following change:

Equity in Earnings for each of VELCO, Vermont Yankee, Connecticut Yankee, Maine Yankee and Yankee Rowe is not revenue credited, nor is the Company's investment in these affiliates included in rate base, nor is there a deduction for equity in earnings of these affiliates in the income tax calculation. This reflects a specific change from the prior case, in which Vermont Yankee was included in the above. The Company believes that the past practice of choosing particular regulated affiliates for inclusion or exclusion is inconsistent; in addition, such adjustments are inconsistent with, and thus may violate, FERC preemption principles where FERC decisions approved the rates of return on common equity for the four Yankees and VELCO.

See Schedule 8, Compliance with Board Rule 2.402(B): Changes from Previous Order, page 4, item 9.

Q: Please summarize the background surrounding this issue.

A: In Docket 6460 CVPS: (a) included their equity investments in the four Yankees, VELCO and Millstone in their rate base, (b) included equity in earnings from these companies in income from affiliates, and (c) included a deduction in their tax calculation for the exclusion of affiliate equity in income. It has been the rate making method and practice adopted by the Board – and followed by all other Vermont electric utilities – to include such investments and income in the preparation of a Cost of Service filing.

In Docket 6545, the Board issued an order on June 13, 2002 that approved the sale of the Vermont Yankee Nuclear Power Station. In connection with the sale, the Board ordered CVPS to file by April 15, 2003, an updated cost of service study to determine if rate decrease(s) were appropriate in 2003 or 2004. The cost of service information as filed by CVPS indicated no rate decrease was appropriate and that, in fact, a rate increase was warranted. The cost of service results indicated a revenue deficiency of 0.8% or \$2.2 million for 2003 and a deficiency of 4.6% or \$12.1 million for 2004. Based on this Cost of Service Filing, which excluded the above referenced investments and equity in earnings except for Vermont Yankee, and the failure to successfully negotiate a settlement, the Department requested an investigation of CVPS's rates.

Q: Do other Vermont Utilities include their investments and equity in earnings/dividend income from regulated affiliates in their rate base and cost of service filings?

A: Yes, to my knowledge, all other Vermont utilities include their similar investment and equity in earnings from regulated affiliates in their rate base and cost of service filings. Most notable is Green Mountain Power, which has included Vermont Yankee and VELCO in its most recent rate filing.

Q: Has CVPS provided any analysis to support their proposed change in rate making methodology.

A: CVPS has provided no analysis or supporting collaboration for their proposed change, other than its Schedule 8, as quoted earlier.

Q. What would the financial impact be on CVPS's rate payers, if CVPS's proposed methodology and rate making principles were to be adopted by the Board and subsequently applied throughout Vermont?

A. Assuming these entities are earning a return as would be expected since they are “regulated”, and further assuming the authorized rates of return are equal to or greater than that which is awarded by the Vermont Public Service Board, the beneficiaries of these exclusions would be the stockholders while the general body of ratepayers throughout CVPS's service area would most likely see a slight increase in their rates. The same financial impact would affect rate payers throughout Vermont if such investments and income were to be excluded by other Vermont regulated utilities in adopting this change from established rate making practices.

Q. Can you explain how Vermont rate payers are negatively impacted when these regulated affiliates are excluded from Vermont rate making?

A. The excluded entities as proposed by CVPS are under the jurisdiction of the FERC for setting tariffed rates and rates of return. The FERC, recently at least, has generally awarded a higher authorized rate of return for companies under their jurisdiction than has the Vermont Public Service Board. Currently, rates of return authorized by FERC are in the range of 12-14% while existing rates of return authorized for companies under the jurisdiction of the Vermont Public Service Board have been somewhat less, perhaps in the 8-10% range. Additionally, 80% of the equity in earnings of affiliates is excluded from Federal and State Income Taxes. Thus, when these investments and equity in earnings are excluded the ratepayer foregoes a revenue source that results in a higher revenue requirement and higher rates.

Q: Should this proposed change in methodology be adopted by the Vermont Public Service Board?

A: No. CVPS has provided no reason, analysis or supporting collaboration that justifies changing the Board's existing methodology.

Q. If CVPS's proposal is not adopted by the Board, how should CVPS's Cost of Service be adjusted?

A. CVPS should update their Cost of Service filing to include all of the excluded

affiliates.

Q: If CVPS's proposed change is acceptable to the Board, are there other related changes that should be considered?

A. Yes. Vermont's rate making methodology should be updated and modified to include only Vermont jurisdictional revenue, expenses and rate base items. Adopting a jurisdictional separations approach would result in excluding the Four Yankee's decommissioning costs and their wholesale activity. Vermont rate payers purchased power from Vermont entities under then existing Vermont tariffs and have no continuing and ongoing responsibility under the tariff to continue to pay. The utilities on the other hand purchased wholesale power from their affiliates under tariffed rates as established by FERC and they become solely responsible for any continuing relationship with their affiliates as stockholders, thus there is no continuing linkage on behalf of Vermont rate payers to absorb the benefits and or risks from non Vermont jurisdictional costs.

C. Discuss the need for a ruling from the Board in this case to establish uniformity and consistency in accounting for: (1) rate revenues associated with the amortization of Regulatory Assets and Liabilities, and (2) the method for calculating actual rates of return for assessing compliance with earnings maximum and caps.

Q. Why is this ruling necessary?

A. Such a ruling will ensure consistency in carrying out Board Orders such as earnings cap orders and accounting orders.

Q. What specifically should the Board rule in this case?

A. The Department recommends that the Board rule that for purposes of Vermont rate making:

1. At the conclusion of an amortization cycle, any rate revenues associated with the amortization of a regulatory asset shall be booked as a regulatory liability for the benefit of ratepayers and shall not be flowed through to income, which inures ultimately to the benefit of shareholders; The effect of this process is reversed when with the amortization cycle is related to Regulatory Liabilities.

2. The method for calculating interim rates of return when assessing conformance with earnings maximums and caps shall be the method that is reflected in Mr. Schultz's testimony in this docket, which is the traditional method for performing such calculations in Vermont.

Q. Please discuss the need for the ruling you have requested regarding accounting for rate revenues associated with the amortization of regulatory assets after expiration of their amortization cycles.

A. Regulatory Assets and Liabilities are conferred with a uniqueness in rate making

that extends to the accounting for these items—a single specific event and the specific related charges are specifically accounted for and are specifically provided for in rates. No other category of expense or investment is so specifically accounted for in rate making. Other categories of expense and investment are considered in the aggregate in normal general rate making practices and changes in those charges are handled through the normal general rate making process.

Regulatory assets and liabilities have been conferred special treatment—and the special treatment includes specific recovery through rates. This special treatment extends to and includes special accounting for these the specific charges and the recovery or amortization of those charges. This special and specific treatment for rate making purposes extends to the accounting where upon completion of the amortization of the regulatory asset and or liability the amounts included in rates for that specific event as long as they are being collected should be accounted for as:

1. A regulatory liability for the completion of the amortization of a regulatory asset, and
2. A regulatory asset for the completion of the amortization of a regulatory liability.

This accounting is required to ensure that the specific regulatory asset and or liability charges are not over recovered in rates; that the rate payers are not being asking to continually pay for a specific event for which the costs or charges have already been fully recovered; and, this accounting is required to ensure that the use of the special treatment afforded regulatory assets and liabilities is not used as a surrogate for ad hoc

general rate making and thus avoiding the general protections afforded ratepayers through the normal rate making process.

Currently, there appear to be two different views of what accounting treatment to afford regulatory assets/liabilities at the end of their respective amortization cycles.

Q. What are these two approaches?

A. They are as follows:

View # 1 (CVPS's Approach):

When amortization is complete for a particular Regulatory Asset/deferred charge, the related rate revenue flows immediately to the bottom line and the ratepayer continues to pay for the regulatory asset/deferred charge until the next general rate case and the company receives an immediate increase in income. The reverse of this situation occurs when the completion of the amortization is related to Regulatory Liabilities. In the Department's view, this is an inappropriate application of the policy and exemplifies why the policy needs to be confirmed and clarified. But CVPS has applied this application and has argued that the existing policy does not prohibit this application and helps them avoid expensive rate cases.

View #2 (The Department's Approach):

When amortization is complete for a particular Regulatory Asset/deferred charge, the related rate revenue is chargeable to Regulatory Liabilities (amounts owed by the

company and to be paid to or returned to their customers). Though while the ratepayer will continue to pay for the regulatory asset/deferred charge until the next general rate case any and all amounts collected that exceed the specific regulatory asset charge is subsequently returned to the rate payer rather than flowing through to the bottom line of the company. The reverse of this situation occurs when the completion of the amortization is related to Regulatory Liabilities. In the Department's view, this is the appropriate approach and it should be uniformly applied to all Vermont utilities when amortizing regulatory assets or liabilities.

Q. Do you want the Board to rule in favor of View # 2?

A. Yes.

Q. Do you want a ruling from the Board that prohibits the practices outlined in View #1?

A. Yes.

Q. Please discuss the need to clarify and confirm the Board's policy regarding the method for calculating interim rates of return when assessing conformance with earnings maximums and caps.

A. As stated and shown in Mr. Schultz's testimony, the method for calculating an interim actual rate of return outside of a formal rate proceeding should be confirmed in this proceeding and uniformly applied throughout Vermont.

D. Discuss The Need For Closer Scrutiny of Depreciation Rates

Q. What is or has happened in the area of depreciation that would warrant an

increased level of focus and attention?

A. First, as a general proposition, the Department is recommending an increased level of "depreciation" awareness and a requirement that utilities perform the completion of future depreciation studies to ensure that depreciation rates and changes in accumulated depreciation are reasonable and determined and accounted for in conformance with generally accepted accounting principles (GAAP) and as prescribed by the Federal Energy Regulatory Commission (FERC).

GAAP and FERC depreciation rules have changed in recent years in ways which the Department believes are relevant to how CVPS and other Vermont utilities should be accounting for depreciation, and that it is in the best interests of ratepayers for the Department to pursue the implementation of these new rules for rate making purposes at the state level.

Q. What does this mean in practical terms?

A. Because of recent changes in GAAP (FAS 143) and at the FERC (Order 631), and due to the what the Department perceives to be widely divergent depreciation reserve ratios and accounting practices among Vermont utilities, there is a need to increase the awareness of the impact of depreciation on rates.

Given these rule changes and the rationale embodied in the changes, it follows that, going forward, a broader and closer scrutiny would be warranted on a case by case basis in rate proceedings in Vermont to consider the merit of applying these new GAAP

and FERC standards at the state level to depreciation, the depreciation reserve, depreciation rates, the regulatory liabilities that may be associated with net salvage and the related accounting.

Q. What would you propose the Board do in the case of CVPS?

A. The Board should apply FAS 143 and FERC Order 631 to CVPS' depreciation rates and resulting calculations, the consequence of which in this case is a significant adjustment to the benefit of ratepayers. For a more detailed analysis and explanation of this conclusion, I would respectfully direct the Board's attention to the prefiled testimony of Michael J. Majoros, Jr.

Q: Does this conclude your testimony?

1 A: Yes.